

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 AID-20 CIAE-00 COME-00 EB-11 FRB-02

INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12 SP-03

CIEP-02 LAB-06 SIL-01 OMB-01 AGR-20 FPC-01 INT-08

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FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 2914

INFO AMCONSUL RI DE JANEIRO

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E.O. 11652: N/A

TAGS: EFIN BR

SUBJ: MARCH COST-OF-LIVING INCREASE HIGHER THAN

EXPECTED. GOVERNMENT REJECTS DEFLATIONARY

MEASURES AND RELIES ON PRICE CONTROLS TO FIGHT INFLATION

REF: BRASILIA 2259

1. SUMMARY: WITH MARCH INCREASE OF 4.6 PERCENT, INFLATION RATE DURING FIRST QUARTER REACHED 9.1 PERCENT, AN INCREASE SOMEWHAT HIGHER THAN OFFICIALS HAD EXPECTED. FIRST QUARTER RESULTS HAVE APPARENTLY RAISED CONCERN IN GOVERNMENT ECONOMIC POLICY-MAKING CIRCLES. FINANCE MINISTER SIMONSEN REITERATED THAT GOVERNMENT WILL NOT RESORT TO SHOCK TREATMENT OF INFLATION, I.E, DEFLATIONARY POLICIES, WHICH WOULD HAVE AN ADVERSE IMPACT ON ECONOMIC GROWTH BUT WILL RELY ON GRADUALISTIC APPROACH TO CONTAIN INFLATION. MINISTER SAID THAT IN LINE WITH THIS POLICY PRICE CONTROL MECHANISM WILL BE APPLIES MORE EFFECTIVELY. END SUMMARY.

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2. THE GUANABARA COST-OF-LIVING INDEX, WHICH IS THE MEASURE NORMALLY USED TO GAUGE INFLATIONARY TRENDS IN BRAZIL, ROSE BY 4.6 PERCENT IN MARCH (OVER FEBRUARY) BRINGING CUMULATIVE INCREASE FOR FIRST QUARTER TO 9.1 PERCENT. COMPARABLE FIGURES FOR 1973 WERE 1.3 PERCENT AND 3.8 PERCENT. FOOD PRICES (10.6 PERCENT) AND PERSONAL SERVICES (11.5 PERCENT) LED LIST OF ITEMS CONTRIBUTING TO FIRST QUARTER INFLATION. IN BOTH INSTANCES, THERE WAS A CERTAIN DEGREE OF CATCHING UP WHICH INFLUENCED THE RESULTS. IN CASE OF FOODS, HIGHER PRICES REFLECTED GOVERNMENT'S DECISION TO WITHDRAW CERTAIN SUBSIDIES; RISE IN PERSONAL SERVICES REFLECTED MAINLY HIGHER GAS PRICES WHICH WENT UP BY 32 PERCENT IN LATE MARCH.

3. AS NOTED REFTTEL, LARGE JUMP IN INFLATION EXPECTED DURING JAN/MARCH PERIOD AS RESULT OF PRICE ADJUSTMENTS PERMITTED BY THIS ADMINISTRATION BUT REFUSED BY PREVIOUS GOVERNMENT. THE ACTUAL INCREASE, HOWEVER, TURNED OUT TO BE HIGHER THAN OFFICIALS HAD ANTICIPATED. PRELIMINARY INDICATION HAD BEEN THAT RATE OF INFLATION WOULD REACH ABOUT 7 PERCENT DURING FIRST QUARTER.

4. HIGH RATE OF INFLATION HAS APPARENTLY BECOME TOPIC OF MAJOR CONCERN TO THE GOVERNMENT. ON SEVERAL OCCASIONS DURING THE PAST WEEK OR SO, THE FINANCE MINISTER HAS REFERRED TO THE NEED TO CRACK DOWN ON HIGHER PRICES. IN ADDITION, THE PRESIDENT HAS HELD AT LEAST ONE MEETING WITH THE MINISTERS OF FINANCE, PLANNING AND AGRICULTURE TO DISCUSS POLICIES AGAINST INFLATION.

5. THE GOVERNMENT'S APPROACH TO INFLATION CONTROL WAS OUTLINED IN A MAJOR POLICY SPEECH GIVEN BY FINANCE MINISTER SIMONSEN ON APRIL 18 BEFORE A GROUP OF SAO PAULO INDUSTRIALISTS. THE MINISTER REITERATED THAT THE GOVERNMENT WOULD NOT USE SHOCK TREATMENT,

I.E., DEFLATIONARY MONETARY AND FISCAL POLICIES, TO SLOW DOWN INFLATION. INSTEAD THERE WOULD BE CONTINUED RELIANCE ON THE GRADUALISTIC APPROACH WHICH SEEKS TO DECREASE INFLATION WITHOUT DECELERATING ECONOMIC GROWTH. THIS WOULD BE DONE, THE MINISTER SAID, BY APPLYING MORE EFFECTIVELY THE PRICE CONTROL MECHANISMS OF CIP AND SUNAB (PRICE CONTROL COMMITTEES FOR INDUSTRIAL AND AGRICULTURAL PRODUCTS, RESPECTIVELY) WHILE LIMITED OFFICIAL USE

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CREDIT WOULD BE PERMITTED TO EXPAND (AT 35 PERCENT) TO MEET THE NEEDS OF A GROWING ECONOMY. THE MINISTER STRESSED, HOWEVER, THAT CREDIT EXPANSION AND APPROVED PRICE INCREASES WOULD BE COORDINATED IN ORDER TO PREVENT REPETITION OF LAST YEAR'S EXPERIENCE WHEN LARGE CREDIT EXPANSION WAS PERMITTED (47 PERCENT INCREASE IN MONEY SUPPLY); THIS WAS INCONSISTENT WITH LOW TARGET FOR PRICE INCREASES WHICH RESULTED IN PRICE DISTORTIONS AND SCARCITIES. HE WARNED INDUSTRIALISTS THAT THEY

WOULD NOT BE PERMITTED BY CIP TO PASS ONTO PRICES ALL INCREASES IN COST OF INPUTS (A POLICY WHICH HE SAID WOULD ONLY PERPETUATE A GIVEN RATE OF INFLATION) BUT WOULD BE EXPECTED TO RELY ON INCREASES IN PRODUCTIVITY TO ABSORB SOME OF THESE HIGHER COSTS. THE MINISTER PROMISED THAT WITHIN THE NEXT FEW MONTHS CIP WOULD BE ADOPTING SEMI-AUTOMATIC FORMULA WHICH WOULD PROVIDE MAXIMUM OBJECTIVITY IN PRICE APPROVAL MECHANISM. AMONG OTHER THINGS, THIS FORMULA WILL INCLUDE FACTOR FOR PRODUCTIVITY CHANIB AND, FOLLOWING SYSTEM NOW EMPLOYED FOR SALARY INCREASES, WILL ALSO TAKE INTO ACCOUNT FUTURE AS WELL AS PAST COST TRENDS. THE MINISTER DID NOT ELABORATE FURTHER HOW THIS WOULD WORK.

6. COMMENT: ALTHOUGH GOVERNMENT OFFICIALS EXPECTED BULGE IN INFLATION DURING FIRST QUARTER, THEY WERE NO DOUBT SURPRISED BY ITS EXTENT. BY WITHDRAWING SUBSIDIES FROM NUMBER OF FOOD PRODUCTS (E.E., WHEAT AND RICE) AND PASSING ON HIGHER COSTS OF IMPORTED PETROLEUM, GOVERNMENT HAD SEEMED TO IMPLY THAT GREATER RELIANCE WOULD BE GIVEN TO MARKET FORCES IN SETTING PRICES. SIMONSEN'S LATEST SPEECH, HOWEVER, IS A STERN REMINDER TO BUSINESS COMMUNITY TO EXPECT CLOSE QUESTIONING BY PRICE CONTROL AUTHORITIES OF ALL FUTURE REQUESTS FOR PRICE INCREASES. WHILE IT IS DIFFICULT AT PRESENT TIME TO ASSESS THE PRACTICAL SIGNIFICANCE OF THE MINISTER'S REMARKS, IT NEVERTHELESS SIGNALS TO BOTH BUSINESS COMMUNITY AND CONSUMERS ALIKE THAT THE GOVERNMENT PLANS TO GIVE THE FIGHT AGAINST INFLATION VERY HIGH PRIORITY, AND THAT THE PRICE CONTROL MECHANISMS WILL BE AN IMPORTANT TOOL IN THIS ENDEAVOR.
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